In the Supreme Court of the United States

OCTOBER TERM, A. D. 1944.

No. .....

THE TERMINAL AND SHAKER HEIGHTS REALTY CO.,
Petitioner,

vs.

CHARLES L. BRADLEY and
JOHN P. MURPHY,
Respondents.

BRIEF IN SUPPORT OF PETITION.

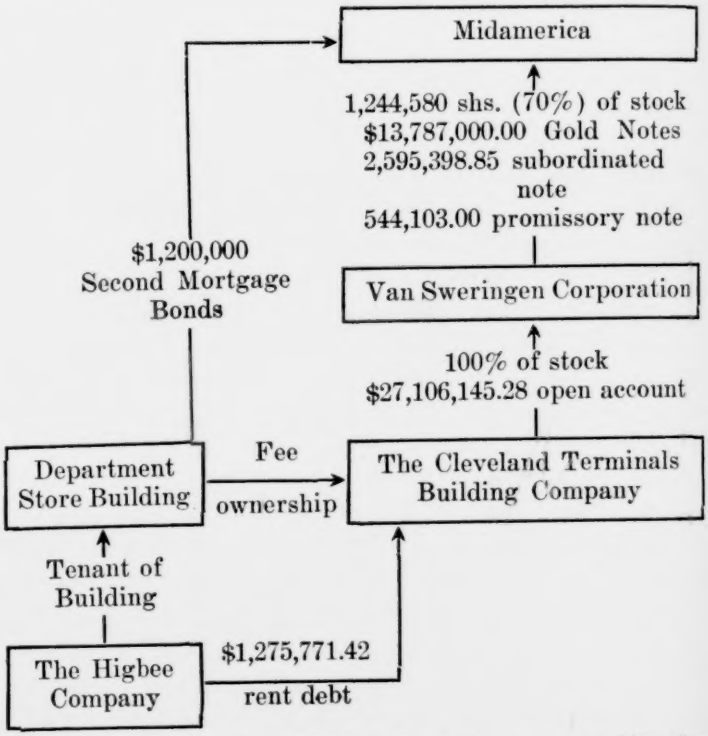
STATEMENT OF THE CASE.

A—Corporate Structure.

During all of the period with which this case is concerned Midamerica was the owner of large claims, direct and indirect, against The Cleveland Terminals Building Company (C.T.B.). These claims were represented by $13,787,000 Van Sweringen Corporation five-year 6% Gold Notes, $2,595,398.85 Van Sweringen Corporation subordinated note, $544,103 Van Sweringen Corporation promissory note and 1,244,580 shares of Van Sweringen Corporation common stock. Van Sweringen Corporation in turn owned all of the capital stock of C.T.B. and a claim against C.T.B. in the amount of $27,106,145.28. Midamerica was also the owner of $1,200,000 principal amount of Second Mortgage 6% Gold Bonds of C.T.B. secured by a second mortgage on the department store building owned by C.T.B. and occupied by Higbee as a tenant (Stip. 29, 30, 31, 32, R. 266-267). C.T.B. in turn was admittedly a creditor of Higbee on notes and for unpaid rent in the amount (as of February 28, 1938) of $1,189,869.93 (Y & K

Ex. 42, R. 458). C.T.B., by proof of claim filed April 22, 1938, claimed that Higbee was indebted to it in the amount of $1,275,771.42 and reserved the right to make a further claim for damages for rejection of leases (Y & K Exs. 39, 40, R. 442-451). C.T.B. also asserted by application that Higbee should affirm or reject the leases which it had entered into with C.T.B. (Y & K Ex. 40, R. 451). Furthermore, Higbee was continuing to occupy the building owned by C.T.B.

For the sake of clarity the relationships of the various individuals and corporations may be set forth graphically as follows:



Bradley was Vice President and a director and Murphy was secretary of Midamerica. Bradley was Vice President

and a director and Murphy was Secretary and a director of Van Sweringen Corporation. Bradley was President and a director and Murphy was Secretary and a director of C.T.B. These relationships continued until January 19, 1938 (R. 289).

B—The Wrongful Purchase.

On September 30, 1935 J. P. Morgan & Co. sold at foreclosure sale large blocks of securities formerly owned or controlled by the Van Sweringen brothers. George Ball of Muncie, Indiana, with an associate, caused the organization of Midamerica for the purpose of bidding at the sale. He was successful in the venture as Midamerica was the high bidder, acquiring for $3,121,000 large blocks of Alleghany Corporation common and preferred stock, certain Cleveland real estate securities including the claims against Van Sweringen Corporation and C.T.B. mentioned above, the Higbee securities which are the subject of this litigation and certain other miscellaneous items. The Van Sweringen brothers were associated with Ball, and were active in the management of the enterprise.

Bradley immediately became Vice-President and a Director of Midamerica and Murphy, its Secretary and counsel. Thus from the very organization of the corporation they acquired intimate knowledge of its affairs.

On April 24, 1937 (the Van Sweringen brothers having died in the interim) Robert R. Young, Allan P. Kirby and Frank F. Kolbe purchased from Ball Foundation 93.67% of the common stock of Midamerica together with substantial blocks of Alleghany securities, pursuant to a contract of sale (R. 44). The purchase price was $6,375,000 of which $4,000,000 was paid in cash and the balance represented by a promissory note. The Higbee securities had been eliminated from the Midamerica portfolio prior to the sale of the Midamerica stock pursuant to a provision in the contract of sale.

On May 15th, 1937, Bradley and Murphy, without notice to the majority stockholders of Midamerica or even to its board of directors, entered into an agreement with Ball Foundation to buy the Higbee securities which are the subject of this litigation and which represent control of the Higbee Company (R. 315-316). The agreement of May 15th was consummated on June 4th by the execution of a bill of sale by Ball Foundation to Bradley and Murphy, the making of a $60,000 cash payment by Bradley and Murphy on account of the purchase price, and the delivery by them to Ball Foundation of their promissory note for $540,000, the balance of the agreed purchase price (R. 19-24).

No claim is made by respondents Bradley and Murphy that they consulted with Midamerica, its Board of Directors or its new owners before this purchase was made. In fact they admittedly acted surreptitiously and concealed their intentions and their negotiations from Midamerica and its new owners until after their arrangements for purchase had been concluded (R. 167).

Midamerica's principal asset was its interest in downtown Cleveland real estate and included a substantial equity interest in the department store building owned by C.T.B. and occupied by The Higbee Company as a tenant as well as a second mortgage in the amount of $1,200,000 on that building. On May 12 and 13, 1937 the new owners, Young, Kirby and Kolbe made their first visit after the purchase to see their new properties in Cleveland.

During those two days they physically inspected all of the properties. Bradley personally escorted them through the Higbee store and pointed out its many advantages and features. They then sat down with balance sheets, income statements and all the financial data which was necessary to a complete understanding of the situation. Bradley's own testimony concerning this occasion is illuminating as

it shows the activities and mental attitudes of all parties concerned at that time (R. 249-250):

"Q. During the course of the inspection tour did you take them through the Higbee store?

A. I think we did.

Q. Do you remember that you went through about every floor of the store?

A. I don't recall that, but we may have.

Q. And that you went up to a radio station on the top floor?

A. We may have done that. Probably did.

Q. That you went into the beauty parlor?

A. We probably did.

Q. And that you pointed out to these gentlemen that it was the very largest beauty department in the city with fifty operators?

A. Well, I don't think I did that because we had more operators. What I said to them was, I think, that it was the second largest in the country. We had better be accurate.

Q. So that you did take Mr. Young, Mr. Kirby and Mr. Kolbe through the Higbee store and they went through the whole place?

A. Yes, sir. They had an interest in the Higbee situation.

Q. Yes. Now, what interest did they have in the Higbee situation, that you discussed with them?

A. I thought at that time they had a very large interest in the Cleveland Terminals Building Company, and they did, too, and the Cleveland Terminals Building Company had a second mortgage, and before they bought into the picture the Cleveland Terminals Building Company had gone into reorganization, and a plan was then being prepared for the reorganization of the Cleveland Terminals Building Company, and a large amount of time, weeks had been spent on it, and months of work had been spent on it, and that second mortgage was being treated in that plan, and I wanted them to know all about it.

Q. Now, you explained all that to Mr. Young and Mr. Kirby?

A. Yes; and to their lawyers.

Q. Yes. You told them of the fact that the second mortgage was for $1,200,000?

A. I told them all the facts.

Q. Well, that is the fact, isn't it?

A. I think it is. Whatever the facts were I told them.

Q. You told them also about the large first mortgage held by The Metropolitan Life Insurance Company?

A. They had all the facts.

Q. You told them that?

A. Yes.

Q. You told them about the back rent claims that C.T.B. had against Higbee?

A. I am sure they were told all about it.

Q. Did Mr. Young ask you for figures on the sales of Higbee?

A. I think he did.

Q. And you discussed that situation with him?

A. I must have. Probably did.

Q. Mr. Young expressed great interest in the progress of the Higbee store and its business affairs?

A. I wouldn't say that. No more so than he was interested in all the things that he came out to look at.

Q. But he did discuss in detail the first mortgage, the second mortgage, the back rent and the sales of the Higbee store?

A. I am sure those were all discussed, yes."

The interest of Young and Kirby in Higbee as was developed in Bradley's presence on May 13, 1937 was indeed distressing to Bradley and Murphy. The telephone records produced at the trial show that on that very same day, May 13, while Young and Kirby were probably having lunch, Murphy called Ball in Muncie, Indiana, on the long distance telephone. As soon as he had concluded his conversation Bradley called Bernard (Ball's assistant). Immediately thereafter Bradley called Ball (Y & K Exs. 36, 37 and 38, R. 441). Admittedly these calls, made in secrecy, were for the purpose of arranging an appointment in

Muncie on May 15 at which Bradley and Murphy could discuss and negotiate with Ball for the purchase of the Higbee securities. They had not mentioned their intentions to the new controlling stockholders of Midamerica.

Bradley and Murphy admit that, although they were purporting to co-operate with Midamerica (R. 248) and the new purchasers of its stock throughout the months of May and June, no information was given by them or anyone else to the new purchasers concerning the said purchase of the Higbee securities, until Bradley communicated the fact to Young on June 7th (R. 167). Young denies that he was given the information until a later date, but for the purpose of this brief, we need not go beyond the testimony of Bradley and Murphy that the purchase from Ball Foundation was agreed to on May 15th, consummated on June 4th, and concealed from Young and his associates until June 7th.

C—Conflict Created by Bradley-Murphy Purchase.

The Higbee Company was in reorganization proceedings when Bradley and Murphy made this purchase. One of the principal obligations of Higbee was its continuing obligation for the payment of rent. Higbee was thus presented with the question as to whether it should assume or reject its lease from C.T.B. Rejection would give C.T.B. a claim for damages provable under the Bankruptcy Act. Adoption would have required payment forthwith of the amounts specified in the lease. This in itself would have been a serious problem for Higbee. But that is not all. The Higbee lease had undergone certain modifications resulting in a reduction of rent. Higbee, however, had not paid, and was not then paying, the rent as so reduced; thus giving rise to the question as to whether Higbee still had a right to take advantage of the reduction in rental, or whether the original rental had been restored automatically or could be restored at C.T.B.'s option. Bradley frankly

testified that the lease from C.T.B. was burdensome, and that it was necessary to relieve this burden in order that the securities which he and Murphy had acquired would become valuable (R. 318 to 320, 442, 451, 458).

C.T.B., in which Midamerica had such a substantial interest, filed its proof of claim against Higbee (R. 442) claiming $1,275,771.42 as a rent debt and reserved the right to assert further claims for damages for rejection of the lease. C.T.B. also filed an application to require the Debtor to assume or reject its leases (R. 451). Bradley and Murphy, who theretofore were supposed to be looking after the interests of Midamerica, changed sides when they acquired the Higbee securities, and, because their self-interest so dictated, they opposed all efforts of C.T.B. to have its claims allowed and to collect for the use and occupation of the Higbee building (see Y & K Ex. 41, R. 455; Y & K Ex. 42, R. 458). Bradley resisted the claim for rent filed by C.T.B. and there resulted extensive litigation not finally determined until passed upon by the Sixth Circuit Court of Appeals (R. 310).

Thus, serious controversies between C.T.B. as landlord and Higbee as tenant had to be litigated or adjusted, relating to the collection of past rentals, the validity and interpretation of the lease and rental agreement, and the fixing of future rentals (R. 306, 308). Midamerica was a substantial direct creditor of Higbee's landlord, and had even greater indirect interests by way of claims and stock ownership through Van Sweringen Corporation. Yet Bradley, a director and officer, and Murphy, an officer and general counsel, of Midamerica, without notice to the other Midamerica officers and directors or to its stockholders, bought for their own account these securities of the tenant, which could have value only if concessions were made by the landlord. They thus put themselves in such a position that their personal interest would necessarily be in conflict

with the Midamerica interests, which Midamerica officers and directors were duty-bound faithfully to protect.

The position which they assumed was so obviously in conflict with their duties to C.T.B. (Midamerica's subsidiary) that on July 2, 1937, just a few days after the public announcement of the Bradley-Murphy purchase, Honorable Charles I. Russo, Special Master in the C.T.B. reorganization proceedings, recommended the appointment of special counsel for C.T.B. and in his report (Stip. Ex. W, R. 300) he made the following statement:

> *"The relationship of the two Companies arising out of the aforestated acquisition of the stock of The Higbee Company by officers of the Subsidiary Debtor appears plainly to leave no alternative, than to take, for the benefit of creditors of Subsidiary Debtor, such precautionary measures as are necessary to avoid the difficulties so often pointed out by the Courts."* (Italics ours.)

The District Court in approving the Master's recommendations specifically found the conflict which had been created, and appointed disinterested representation for C.T.B. (R. 302-4).

This conflict in Bradley's and Murphy's position was no less grave in respect of Midamerica, whose principal asset was its interest in C.T.B. and particularly the $1,200,000 of C.T.B. bonds secured by a second mortgage on the Higbee building, which mortgage could only be serviced and amortized by rental payments made by Higbee as tenant.

One very important immediate effect of the Bradley-Murphy purchase was to deprive Midamerica of the attention of Bradley to the duties incident to the position he occupied. On June 27, 1938 Murphy testified that Bradley had, since the Bradley-Murphy purchase, "become the President" of Higbee and "devoted a great part of his time, in fact most of it * * * to the affairs of the Higbee Company" (B & M Ex. 7, R. 388). Thus it is apparent

that Bradley was devoting practically all of his time to Higbee and completely disregarding the interests of Midamerica.

It is difficult to conceive of a breach of trust involving a fiduciary in more inconsistent positions. The applicable rule of law was created to prevent the slightest departure from the line of duty to one's master. But here the ensuing waves of conflicting loyalties are so many and involved as to point up the unconscionable nature of Bradley's and Murphy's conduct. Not only did they buy for themselves property desired by their principal, for whom they were acting; not only did they, as part of the price, involve themselves in inevitable future disloyalty; but they placed themselves in the position in which the performance of their duty to the corporation of which they were officers and directors, would injure their personal interest in the securities acquired. They were faced with the constant conflict the law intended must never exist, of serving themselves at the sacrifice of their fiduciary obligations.

On July 15, 1937, Young, having learned of the Higbee purchase, wrote Bradley (Y & K Ex. 27, R. 424) who, with Ball and Bernard, continued to control the Board of Directors of Midamerica (although Young, Kirby and Kolbe owned substantially all of its stock) and asked Bradley to remove the Board of Directors and elect a new board which Young had told him was to be Young, Kirby, Kolbe, McKinney and Ball (R. 171). This request was refused by Bradley.

In August 1937 Mr. Milton A. Kramer, attorney for the Young interests, came to Cleveland and, after having been instructed so to do, he pointed out to Murphy the conflicting position which Murphy and Bradley had assumed by their acquisition of the Higbee securities. He was instructed by Young to take a firm stand with Bradley and Murphy, and pursuant to those instructions he made

known Young's position that Bradley and Murphy had assumed a conflicting position because they were representing the landlord, the second mortgagee and the owner of the equity in C.T.B., the landlord, at the very time they acquired for themselves a controlling interest in Higbee, the tenant (R. 98).

In January, 1938 Bradley and Murphy finally recognized that on May 15, 1937 they had placed themselves in conflict with duties owing to their employers, because they then resigned as directors and officers of C.T.B. and Midamerica (Stip. Ex. U, R. 290-292).

Bradley and Murphy *never* voluntarily disclosed the price and terms of their purchase. On June 27, 1938, more than a year later, and after Midamerica had made formal application therefor, Murphy was examined as a former officer of C.T.B., and was thereupon forced to disclose the details of the deal with Ball (R. 179).

ARGUMENT.

During the year 1937 Bradley and Murphy were executive officers and Bradley a director of Midamerica. Both were executive officers and directors of Higbee's landlord, C.T.B., then in bankruptcy reorganization. Midamerica held a second mortgage on the building owned by C.T.B. and occupied by Higbee under a disputed lease on which substantial rental obligations were in arrears. Midamerica also owned very large claims against C.T.B.

Bradley and Murphy, with full knowledge of this situation, in 1937 secretly purchased controlling interest in Higbee while it was also in bankruptcy reorganization. Shortly after that purchase, Bradley, who already was a director, became president of Higbee. At the same time Murphy became a director. Conflict was inevitable, and it was recognized by the Circuit Court. We quote from the opinion in this case:

> "If C.T.B. had any substantial interest in this matter * * * we think that a substantial conflict of interest would have been created between the parties" (R. 566).

The court undertook, however, to measure the amount of C.T.B.'s interest in opposition to Higbee, and apparently to weigh it against the value of the interest which Bradley and Murphy had acquired. Having done so it concluded that the interest of C.T.B. was not sufficiently substantial to warrant the imposition of a constructive trust on the Higbee securities. This action by the Circuit Court was in error for the following reasons:

1. To measure the quantum of interest is a departure from sound judicial practice and is neither within the capacity nor the scope of a court's purview in deciding a case.

Judge Cardozo said, in *Meinhard vs. Salmon,* (commented on below):

> "No answer is it to say that the chance would have been of little value even if seasonably offered. Such a calculus of probabilities is beyond the science of the chancery."

2. The Circuit Court's conclusion that the interest of C.T.B. in Higbee was not substantial in 1937 was contrary to what all parties believed at that time (R. 249). It was based upon the decision by the same court rendered in 1939 in *The Higbee Company vs. The Cleveland Terminals Building Company,* 106 F. (2d) 796. The decision in the instant case has the effect of antedating the judgment in the C.T.B. case from 1939 to 1937.

Substantial Interest.

The Circuit Court found that, but for circumstances discussed below, "a substantial conflict of interest would have been created between the parties," that is, between Midamerica on the one hand and Bradley and Murphy

on the other. The court thus recognized that a conflict of interest was inherent in the situation. The court, however, refused to impress a trust on the Higbee securities largely because it was of the opinion that Midamerica's interest in Higbee was not substantial.

Courts of equity have not heretofore attempted to weigh or appraise the extent of a litigant's interest in a subject concerning which there is an admitted conflict. So long as Midamerica had any interest in the Higbee situation, whether great or small, then the admitted conflict was objectionable and the fiduciary relationship of Bradley and Murphy to the corporation must be recognized by holding them accountable for their purchase at the election of Midamerica.

The well-known case of *Meinhard vs. Salmon*, 249 N. Y., 458, deals with this very point. In that case Meinhard and Salmon were joint adventurers in a lease of property in New York City. Meinhard advanced the money and Salmon operated the business. The profits were divided. Shortly before the expiration of the lease Salmon, for himself alone, negotiated a new lease covering the same property originally leased and a large adjacent parcel. The new lease was different from the old one in that it required the erection of a building covering the entire leased premises and involved a much larger rent than required under the original lease. Meinhard had no knowledge of this situation until after Salmon had entered into the new lease. The court, speaking through Judge Cardozo, impressed a constructive trust on the new lease for the benefit of Meinhard.

Salmon contended that the original venture was about to end and that there was no obligation for the partnership to continue. The court agreed with that, but found that Meinhard was entitled to a chance to compete with Salmon for the new lease. Obviously that chance was of doubtful monetary value. Quite evidently Meinhard's in-

terest in the situation was not substantial. Nevertheless, the court there held it is no defense to Salmon because Meinhard's chance was of little value and that the court could not weigh the value of Meinhard's chance. We quote from Judge Cardozo's opinion:

> "The pre-emptive privilege, or, better, the pre-emptive opportunity, that was thus an incident of the enterprise, Salmon appropriated to himself in secrecy and silence. He might have warned Meinhard that the plan had been submitted, and that either would be free to compete for the award. If he had done this, we do not need to say whether he would have been under a duty, if successful in the competition, to hold the lease so acquired for the benefit of a venture then about to end, and thus prolong by indirection its responsibilities and duties. The trouble about his conduct is that he excluded his coadventurer from any chance to compete, from any chance to enjoy the opportunity for benefit that had come to him alone by virtue of his agency. This chance, if nothing more, he was under a duty to concede. The price of its denial is an extension of the trust at the option and for the benefit of the one whom he excluded.
>
> No answer is it to say that the chance would have been of little value even if seasonably offered. Such a calculus of probabilities is beyond the science of the chancery."

The final paragraph of the above quotation expresses in superb language our view on this point. In 1937 Midamerica was asserting large claims against C.T.B., one of which, in the amount of $1,200,000, was secured by a second mortgage on the building occupied by Higbee as tenant. C.T.B. in turn was asserting large rental claims against Higbee under a disputed lease. The ultimate value of those claims could not at that time be predicted; it depended, of course, largely on the outcome of litigation then pending and then being initiated, in which the officers of Midamerica were in duty bound to maintain undivided loyalty to the corporation.

Another case in which the court brushed aside the plea of a faithless fiduciary that no substantial interest was involved is that of *Irving Trust Co. vs. Deutsch*, 73 F. (2d) 121. This case, decided by the Second Circuit Court of Appeals in 1934, announces the rule of strict accountability of fiduciaries and allows no exceptions to that rule. The decision of the Sixth Circuit Court in the instant case relieving Bradley and Murphy of their obligation to account to Midamerica for their purchase of the Higbee securities, because Midamerica's interest in Higbee was "not substantial" is thus directly in conflict with the decision of the Second Circuit Court.

The facts in the *Irving Trust* case are that former officers of Acoustic Corporation, a bankrupt, had taken advantage of a contract which the trustee in bankruptcy claimed should have been given to the corporation. We quote from the court's opinion.

> "The defendants' argument, contrary to *Wing v. Dillingham*, that the equitable rule that fiduciaries should not be permitted to assume a position in which their individual interests might be in conflict with those of the corporation can have no application where the corporation is unable to undertake the venture, is not convincing. If directors are permitted to justify their conduct on such a theory, there will be a temptation to refrain from exerting their strongest efforts on behalf of the corporation since, if it does not meet the obligations, an opportunity of profit will be open to them personally.
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> * * * * *
>
> If the directors are uncertain whether the corporation can make the necessary outlays, they need not embark it upon the venture; if they do, they may not substitute themselves for the corporation any place along the line and divert possible benefits into their own pockets. 'Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrat-

> ing erosion'' of particular exceptions.' *Meinhard v. Salmon,* 249 N. Y. 458, 464, 164 N. E. 545, 546, 62 A. L. R. 1.''

In the *Irving Trust* case the court recognized the danger of allowing a particular exception to the rule of fiduciary responsibility because a corporation may not have the means to take advantage of its rights. In that case Acoustic Corporation's interest in the contract, because of its lack of funds, was of doubtful monetary value, and could not have been substantial. Clearly the decision turned, not on the extent of Acoustic Corporation's interest, but on the fact that it had any right or interest in the subject.

The rule of the Second Circuit Court was followed without limitation in the recent case, *In re Standard Commercial Tobacco Co.,* 34 Fed. Supp. 304. That decision was by the District Court for the Southern District of New York in 1940. In its opinion the court quoting from Lord Eldon *Ex Parte James* 8 Ves., said:

> '' 'The purchase is not permitted in any case, however honest the circumstances; the general interests of justice requiring it to be destroyed in every instance; as no court is equal to the examination and ascertainment of the truth in much the greater number of cases.' ''

We thus see that, since Lord Eldon's time, once the conflict is established, the circumstances, no matter how honest, cannot alter the fiduciary's obligation. Whether Midamerica's interest in the Higbee securities later turned out to be substantial or only nominal makes no difference in the application of the rule of accountability by Bradley and Murphy as fiduciaries.

Antedating a Judgment.

In the Circuit Court's opinion in the instant case, the Court referred to its decision in 1939 in the suit brought by C.T.B. against Higbee for rent claims. There the Court held in substance that the large claims asserted by C.T.B. were only enforceable in part. We quote from the opinion in the instant case:

> "This court, in *Higbee Co. v. Cleveland Terminals Building Co.*, 106 Fed. (2d) 796, 799, 800, held that the trustee thus became the real party in interest and the beneficial owner of notes aggregating more than $570,000, for rent due from the lessee. The Cleveland Terminals Building Company had only a nominal interest in the building, * * *." (R. 567.)

(In passing we point out that as owner of the second mortgage Midamerica had an interest in the building which was prior to that of C.T.B.)

It appears that the Circuit Court regarded the instant case as a challenge to the correctness of its decision in the C.T.B. rent case. The Court evidently felt it necessary, in order now to sustain its decision in 1939, to find in this case that at a time two years earlier, namely on May 15, 1937, Midamerica's interest in the Higbee situation was but nominal.

We do not here question the correctness of the Circuit Court's decision in the C.T.B. case. However, that case dealt only with C. T. B.'s right to collect certain rent claims from Higbee; C.T.B.'s interest in the Higbee building was not one of the issues to be decided. The important point is that the decision, whether it went beyond the scope of the question before the Court or not, was rendered in 1939.

In 1937, everyone connected with the situation thought that C.T.B.'s interest in Higbee was very substantial. (R. 249.) Its rent claim which certainly was a debatable question was for $1,275,771.42. Since no one could know in 1937 the final outcome of litigation which was to end in 1939,

Bradley and Murphy in the instant case cannot now be absolved from their fiduciary obligations to Midamerica which existed in 1937, because of a decision in a case to which Midamerica was not a party, rendered in 1939.

Because of the unforeseen outcome of the C.T.B. case, in which Bradley and Murphy, after their purchase of the Higbee securities, gave their efforts in favor of Higbee and against the rights of C.T.B. and Midamerica, we now find them doubly rewarded for assuming a position in which they could not faithfully serve both masters. First, Higbee gained at the expense of C.T.B. and Midamerica. Second, by force of the C.T.B. decision in 1939, Bradley and Murphy were excused from accounting for their violation of fiduciary duty in purchasing the Higbee securities in 1937. If the present decision of the Circuit Court is permitted to stand, we have at last found the case where two wrongs make a right.

The decision of the Circuit Court in the instant case has the effect of rendering a *nunc pro tunc* judgment in *Higbee Co. v. C.T.B.*, antedating that decision from 1939 to 1937. Courts only resort to *nunc pro tunc* entries to correct an error or to prevent a miscarriage of justice. In this case, to antedate the effect of the C.T.B. decision that Midamerica's interest in 1939 in the Higbee situation was not substantial, serves to reward fiduciaries for their faithlessness.

Estoppel.

The Circuit Court held that Midamerica was estopped to assert its equitable claim against Bradley and Murphy. We quote from the Court's opinion:

> "On June 3, 1942, before the hearing in this proceeding began, Midamerica notified Bradley and Murphy that it would accept payment of the note, and Bradley and Murphy again borrowed the necessary sum and paid in open court the amount of $566,290.36 * * *. Thus

Midamerica placed itself in a position sharply inconsistent with the position which it now asserts. If Bradley and Murphy were obliged to pay the note, then their purchase was valid and they have both legal and equitable title to the securities. By its demand for payment, Midamerica acquiesced in the transaction and recognized the rights of Bradley and Murphy." (R. 567, 568.)

It is evident that the Circuit Court never understood Midamerica's position in this matter. We have always contended that Bradley and Murphy acquired legal title to the securities from Ball Foundation. There was a financial encumbrance on that title in the note which Bradley and Murphy signed in favor of Ball Foundation, to which the Higbee securities were attached as collateral. In an entirely independent transaction resulting from the settlement of litigation between Ball Foundation and Young and Kirby, the Bradley and Murphy note and the accompanying collateral were transferred to Midamerica. The transfer was an incident in the course of business between other parties and involved no relations between Midamerica and Bradley and Murphy.

Bradley and Murphy claimed that they suffered a detriment in paying their note because as a preliminary step, they had borrowed money to make the payment. As a prerequisite to borrowing on the Higbee securities as collateral, they had paid $115,000 to procure the dismissal of an appeal in the Higbee reorganization proceedings then pending in the Sixth Circuit Court, wherein the reorganization plan as approved by the District Court had been objected to by certain preferred stockholders on the ground that Bradley and Murphy as owners of the Higbee securities herein questioned, were to be given too large a share at the expense of the preferred stockholders.

Thus to enable themselves, at one stroke, to remove the threat that the Higbee reorganization plan, favorable to

Bradley and Murphy as then drafted, might be upset, and at the same time to remove the danger that their Higbee securities, which were collateral to their long past due note, might be foreclosed, Bradley and Murphy thought it desirable to buy the pending appeal and cause its dismissal. Their decision to take this step was based upon their own judgment.

The price they paid to buy the preferred stockholders' appeal was about $100,000 above the then market value of the preferred stock which they acquired. This transaction is the subject of other litigation wherein the preferred stockholders, J. F. Potts and William Boag, have been asked to turn over the profit they made above the market value of their securities to the preferred stockholders as a class. The Sixth Circuit Court of Appeals affirmed the District Court in holding that Potts and Boag need not account for their unconscionable profit. (142 F. (2d) 1004.) Petition for writ of certiorari was filed in that case which bears No. 342 on the Supreme Court docket and is now pending decision.

On March 2, 1942, Bradley and Murphy borrowed money to pay the note and tendered it to Midamerica as they had a right to do. For reasons concerning the details of the tender, which are not pertinent here, the tender was refused. Three months later Midamerica accepted Bradley and Murphy's payment of the note without additional interest for the time subsequent to the original tender.

Midamerica had no choice about the matter. It was obliged to accept a valid tender under penalty of losing all interest on a very large sum of money pending the final outcome of this litigation. However, the effect of the payment of the note in no way changed the equitable rights of Midamerica against Bradley and Murphy for their misconduct in purchasing the Higbee securities. By borrowing the money and paying the note, Bradley and Murphy merely paid a pre-existing debt by substituting one creditor for another.

The corporation now has the equitable right under the doctrine of constructive trust to elect to require Bradley and Murphy, upon proper reimbursement, to transfer their legal title to Midamerica. In 1942, Midamerica, through the happenstance of a settlement of other litigation, came to be the holder of an encumbrance against Bradley and Murphy's legal title, which it was obliged to deliver to them upon tender of payment. Midamerica did not thereby impose any new obligation on Bradley and Murphy.

Midamerica has in no manner recognized any equitable interest to the Higbee securities in Bradley and Murphy. On the contrary, it has continuously and vigorously asserted that equitable title to the securities is exclusively in Midamerica.

Our equitable claim has always been subject to reimbursement to Bradley and Murphy of all their legitimate costs, including of course, the payment made to Midamerica itself. Bradley and Murphy suffered no legal or equitable detriment when they paid in full a past due obligation voluntarily assumed by them. If equity should later compel them to give up the securities which they were disqualified by their fiduciary relationship to acquire, equity will also decree full reimbursement to them of legitimate costs, under the rule of *Ashman v. Miller,* 101 F. (2d) 85, and they will still suffer no detriment. In the absence of detriment to Bradley and Murphy a necessary element of estoppel is lacking.

Laches.

The Circuit Court agreed with the conclusion of the Special Master (R. 506) and the District Judge (R. 526) that the statute of limitations does not bar this claim, but overruled the District Court in holding that laches existed irrespective of the statute of limitations.

When the purchase was made from the Ball Foundation in 1937, Bradley and Murphy paid down $60,000 and

signed a note for $540,000. No substantial payment was made on the principal of that note until it was paid off in full as recited above. The terms of the note specifically limited the liability of Bradley and Murphy to the value of the Higbee securities which were attached to the note as collateral. During the four years that elapsed before this litigation was commenced, proper compensation was awarded by the bankruptcy court to Bradley and all others who rendered services of value to the Higbee Company.

However, the most important facts regarding the question of laches were the rulings of the Special Master and the District Court during the course of the reorganization proceedings, that the plan of reorganization should first be worked out and agreed upon and that determination of the several claims to ownership of the Higbee securities should be deferred until the reorganization plan might be approved.

On March 2, 1939, the Special Master filed his memorandum in respect of a motion made by Bradley and Murphy (Y. & K. Ex. 29, R. 426), holding, in part, as follows:

> "The primary purpose of this proceeding is to reorganize The Higbee Company and the Debtor admits, as apparently do all parties herein, that The Higbee Company received the money evidenced by this note and has this debt to be reckoned with in any plan of reorganization. So it would seem the first thing to be done is to adopt a plan of reorganization which would include this claim. Then, at some later hearing it could be determined who is the actual beneficial owner of the claim recognized in the plan of reorganization. Whatever stock, securities or money would go to this claim would be set up in the plan and the determination as to who should receive it could later be made. That is to say, the Court at this time is more interested in a feasible plan and its adoption by creditors than it is in who is to receive a particular share in the plan."

* * * * *

"However, the Master is of the view that at this time the best interests of the Debtor will be served, and progress made in the reorganization proceedings by postponing any action by this Court which goes to the determining of the ownership of this note. As indicated before, the Master is now interested in proceeding with a plan of reorganization and devoting the Court's time and counsel's time to the consideration of a plan and hearings upon questions which must necessarily be disposed of first. When the plan has been approved this question of ownership, if it still exists, will be disposed of either by the Court exercising its discretion to retain jurisdiction of this claim or refusing to hear it."

The plan of reorganization also defers the determination of the ownership of these securities in compliance with the policy expressed by the Special Master in his opinion of March 2, 1939 (R. 361). Reference to this subject was made in the plan because in 1938 opposing claims for the equitable title to the Higbee securities were filed in the reorganization proceedings. When Midamerica's claim was filed it had the effect only of adding a new name to the list of claimants. Midamerica's claim did not originate a contest against Bradley and Murphy.

On June 12, 1941, the Special Master again recognized this policy when he deferred action on the application of Young and Kirby for leave to file proof of claim pending the completion of proceedings on the plan (R. 51).

Bradley and Murphy did not take any exception to the Master's orders, and were even insistent that the matter be delayed for a year after the Young-Kirby claims were filed while the plan was being confirmed. On this delay the District Judge said in his opinion of May 5, 1942:

"The object and purpose of this stay and adjournment of hearing was to avoid any impairment or delay in bringing about a conclusion of the Higbee reorganization."

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> "The bar order of October 6, 1939, clearly was for the purpose, as the Master said in his report, of determining the persons who were to have the right to vote on the plan. *All questions as to the ownership of the junior indebtedness were to be postponed* under an escrow agreement between the then claimants, dated June 4, 1937. Thus, the bar order was not to affect the question of the right to ownership of the junior indebtedness." (Emphasis added.) (R. 87.)

Midamerica was thoroughly justified in relying upon the numerous orders of the District Court to which Bradley and Murphy fully acquiesced from the beginning. For the Circuit Court now to rule that a claimant in the Higbee reorganization proceedings is guilty of laches because it relied upon the specific orders of the Master and the District Judge relating to the very question before the court, penalizes Midamerica most unfairly.

During the trial of the instant case before the Master, Bradley and Murphy claimed that Midamerica was guilty of laches. The Master found that there were no laches (R. 506). No exception was taken to that finding. All findings of the Special Master were confirmed by the District Court (R. 526) and again no exception was taken by appellees. Bradley and Murphy filed no appeal proceedings in the Circuit Court and asked for no relief against any order of the Master or the District Court. Midamerica did not raise the question of laches. That subject was not before the Circuit Court. Its ruling thereon is clearly beyond the questions presented in the case it decided.

By deciding that Midamerica's interest in the Higbee securities is barred by laches, the Circuit Court has adopted a new procedural technique heretofore unknown to federal practice. 28 U. S. C. A. Sec. 862, dealing with the previous practice of filing writ of error to an appellate court, provides that an assignment of errors shall be included in the writ of error. By virtue of 28 U. S. C. A. Sec. 861a, writ of error was abolished in 1928 and thereafter litigants com-

plaining of the trial court were granted relief by appeal.

Under 28 U. S. C. A. Sec. 861b, we find that the procedure under the former practice of writ of error shall be applicable to the appeal.*

In the modern practice of the Federal Rules of Civil Procedure adopted by the Supreme Court, pursuant to Act of June 19, 1934, we find that in lieu of assignments of error, if the appellant does not designate for inclusion the complete record, he shall, as in this case, serve with his designation a concise statement of the points on which he intends to rely on his appeal. This is provided for in Rule 75 (d) of the District Courts of the United States of the Rules of Civil Procedure just referred to. Rule 75 (d) is as follows:

> "Statement of Points. If the appellant does not designate for inclusion the complete record and all the proceedings and evidence in the action, he shall serve with his designation a concise statement of the points on which he intends to rely on the appeal."

Midamerica filed its statement of points (R. 540). There is no reference in that statement of points to the subject of laches. We quote the first paragraph of Rule 10 of the Sixth Circuit Court of Appeals:

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* 861a. **Writ of error abolished; substitution of appeal.**—The writ of error in cases, civil and criminal, is abolished. All relief which heretofore (January 31, 1928) could be obtained by writ of error shall hereafter be obtainable by appeal.

861b. **Statutes governing writs of error to apply to appeals.**—The statutes regulating the right to a writ of error, defining the relief which may be had thereon, and prescribing the mode of exercising that right and of invoking such relief, including the provisions relating to costs, supersedeas, and mandate, shall be applicable to the appeal which the preceding section (861a of this title) substitutes for a writ of error.

862. **Removal of causes by former writ of error.**—There shall be annexed to and returned with any writ of error for the removal of a cause, at the day and place therein mentioned, an authenticated transcript of the record, an assignment of errors, and a prayer for reversal, with a citation to the adverse party.

"10. Appeals in Civil Actions.—1. Federal Rules of Civil Procedure adopted by the Supreme Court pursuant to Act of June 19, 1934, Nos. 73, 74, 75 and 76, are adopted as rules of this court in cases to which they may apply."

Clearly laches was not a question for consideration by the Court of Appeals. So far as the decision was based on that point, it involves a departure from the court's own rules and from the Federal Rules of Civil Procedure adopted by the Supreme Court. Moreover, there is no merit to appellees' defense of laches because of the several rulings of the Master and the District Judge, which deferred any consideration by the District Court of the pending claims to equitable ownership of the Higbee securities.

CONCLUSION.

In the petition for the writ of certiorari preceding this brief, we have presented three questions that definitely bring this case within Supreme Court Rule 38 paragraph 5 (b).

1. The decision of the Sixth Circuit Court of Appeals is in conflict with the decision of the Second Circuit Court of Appeals in the case of *Irving Trust Co. vs. Deutsch,* 73 F. (2d) 121.

2. The judgment complained of has decided important federal questions regarding the administration of bankruptcy reorganizations which have not been, and should be, settled by the Supreme Court.

3. In antedating the effect of its judgment in the C.T.B. rent case, 106 F. (2d) 796, and in introducing the element of laches which was not presented in the appeal, the Sixth Circuit Court has so far departed from the accepted and usual course of judicial procedure as to call for an exercise of the Supreme Court's power of supervision.

In view of the foregoing we request the Supreme Court to grant the petition for writ of certiorari.

Respectfully submitted,

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